

**AGENDA ITEM 4b
INTERNAL AUDIT SUMMARIES
AS OF DECEMBER 31, 2010**

Internal Audit Summaries for Second Quarter of 2010-11

Real Estate Investment Internal Control Framework Review

- **Why Office of Audit Services Performed this Review**

The Office of Audit Services performed an Internal Control Framework assessment in phases by asset class. This is the third report out of a series of four reports. The primary objective of our review was to identify and assess the adequacy of the internal control framework utilized by the Real Estate Unit (REU) to ensure effective and efficient operations, reliable reporting of investment assets, and adherence to relevant laws, regulations and policies.

- **What Office of Audit Services Found**

Our review revealed that the signature authority for wire transfers does not clearly state whether the authorized limit is per transaction or in total over a specified period of time. Also, the language on the authorized signature list does not specify or limit the type of investment activities staff can authorize. We also found that the 2007 strategic plan developed when the real estate markets were relatively stable remains the most current plan approved by the Investment Committee. We also noted that the REU does not have a formal risk management framework that is used to help identify, assess and reduce risks to an acceptable level. Additionally, the current REU procedures do not support and are not aligned with the revised 2009 Policy. There is no requirement for the Senior Investment Officer of the Real Estate Unit (SIO-RE) to formally explain decisions made in conflict with the Investment Review Committee decision. Finally, at the time of our review, REU had not yet developed a standardized list of required and recommended terms as required by Policy.

- **What Office of Audit Services Recommends**

The authorized signature authority should clearly indicate the maximum amount allowable for each signature authority per transaction and in total allowed over a specified period of time. Investment Office should clarify the language on the authorized signature list to specify the type of investment activities staff can authorize. Also, the REU should continue its efforts to refresh the REU 2007 strategic plan to reflect changes in the real estate markets. The REU should consider developing a risk management framework and incorporate this framework into its procedures manual. In addition, the REU should finalize the draft procedures and provide copies to staff for guidance. The draft procedures should be modified to require the SIO-RE to document the rationale for making decisions that are within the SIO-RE's delegated authority, but conflict with the Investment Review Committee and the Board Real Estate Consultant's opinion. Lastly, the REU should develop a standardized list of required and recommended terms and include it in the procedures manual.

- **Management's Response and Action Plan to Strengthen Controls**

Management concurs with the Office of Audit Services' observations and has begun to implement some of the recommendations.

- **Positive Controls Noted**

Certain key responsibilities appropriately reside in areas outside of the REU indicating an adequate separation of duties. Staff roles and responsibilities are clearly outlined in Functional Position Descriptions. Also, the REU established an Investment Review Committee to make informed investment decisions and approve policy exceptions. Additionally, portfolio management and monitoring consists of weekly meetings with various staff, management, and external partners as well as utilizes various monitoring tools.

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Review of Real Estate Program Management Review

- **Why Office of Audit Services Performed this Review**

The primary objective of this review was to assess whether controls over the real estate program are operating effectively.

- **What Office of Audit Services Found**

We found opportunities to strengthen the controls over the real estate program. Specifically, the Real Estate Unit (REU) does not consistently track or document its evaluation of investment opportunities. In addition, the REU has not finalized procedures to provide further guidance on policy requirements. We found the REU could enhance controls over the development of partnership agreements to include clearly defined standard terms and conditions as well as complete the development of a central repository of partner agreements with relevant accompanying documents. Finally, REU could strengthen its documentation to support its monitoring and reporting controls.

- **What Office of Audit Services Recommends**

REU should maintain a system that consistently tracks investment opportunities. To ensure the REU obtains accurate reports from partners and provides reliable reporting to management and the Investment Committee, we recommend the REU finalize its procedures for the receipt and analysis of partner reports and ensure it maintains evidence demonstrating the review and approval. We also recommend the REU finalize the draft procedures related to the preparation and approval of reports submitted to the Chief Investment Officer (CIO) and the Investment Committee. To further demonstrate the REU meets its fiduciary responsibility when executing agreements and monitoring external partners or managers (partners), the REU should include and adequately define standard terms and conditions within agreements or other governing documents and document meetings held within the REU, and meetings held between the REU staff and partners.

- **Management's Response and Action Plan to Strengthen Controls**

Management concurs with Office of Audit Services' observations and has begun to implement some of the recommendations.

- **Positive Controls Noted**

Overall, we found the controls evaluated were adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives are met. Policies exist to govern the management of the real estate portfolio. The Statement of Investment Policy for Responsible Contractor Program specifies responsibilities of partners related to contractor duties, self-certification, enforcement procedures, and complaint procedures. In addition, the REU periodically updated the Investment Committee on the strategic plan during the period under review. Further, the SIO-RE meets weekly with different levels of management, staff and the Real Estate Consultant to discuss key issues and obtain status updates on investments.